ESTATE PLANNING IN NORTH CAROLINA

Federal and State Gift and Estate Taxes

Learn about federal gift and estate taxes—what they are, how they are calculated, and how they may be avoided or reduced.

Although the gift tax and the estate tax are separate taxes, both the federal and state rules that govern them are interrelated. By using the rules wisely, you can reduce or eliminate federal estate tax liability. Additional taxes may affect your estate plan, including the North Carolina gift tax, estate tax, and other taxes.

Who Needs Tax Planning?

You may need tax planning depending on how much you own, how much you give away each year, or both. If what you own is worth more than $2 million (applies only to deaths in 2006 through 2008), you may benefit from tax planning. If what you give away is worth more than $12,000 per year per person, you also may benefit from tax planning. Tax planning maximizes the use of credits, deductions, exemptions and exclusions allowed under the gift and estate (transfer) tax laws. Tax planning requires knowledge of some basic concepts, federal estate and gift tax legislation, and state tax laws.

Basic Concepts and Terms

Transfer taxes. The federal government taxes the transfer of property between individuals. All property is subject to transfer taxes, including *real property* (real estate) and *personal property*, such as bank accounts, jewelry, cars, cash, stocks and bonds. If you give away property during your lifetime, you may be liable for gift tax. If you transfer property at your death, your estate may be liable for estate tax. Gift and estate taxes are called *transfer taxes* because the tax is on the transfer of real and personal property.

Unified estate and gift tax. Transfers of property, either during your lifetime or at death, are taxed under a single taxation scheme—the unified estate and gift tax. The term *unified* means single. A single tax rate schedule applies to both gift and estate taxes. A single credit also applies to both taxes. The rules are interrelated, so that gift tax liability incurred during your lifetime can affect your estate tax liability. Note that the Economic Growth and Tax Relief Reconciliation Act of 2001 partially decoupled the estate and gift tax, making the calculation of whether to make a lifetime gift or a transfer at death more complicated.

Unified credit. A unified credit is an applicable credit amount that exempts a certain amount of property from taxes on gifts made during lifetime or on estates passing at death. The unified credit can be used only once, either during life to offset gifts or at death to offset the calculated federal estate tax. If you make large gifts during your lifetime, you may use the unified credit to avoid owing gift tax. Any unified credit amount that you use against your gift tax in one year reduces the amount of credit that you can use against your gift tax in a later year. To the extent that you use the credit during your lifetime, it will not be available to your estate at your death. Ask your lawyer for advice before making large gifts.

Federal Tax Rates and Exemptions

Based on the size of an estate or a gift, certain estate and gift tax rates apply. The Internal Revenue Code also allows exemptions on these taxes up to certain limits.

With the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the applicable estate tax exemption amount increases until the estate tax is repealed in 2010. Table 1 shows the amount of property sheltered by the applicable exemption amount along with the applicable unified credit amount for estates settled between 2001 and 2010. To better understand a unified credit, see the "Basic Concepts and

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